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## Latin America Review

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9 May 1986

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Latin America  
Review

25X1

9 May 1986

		Page	
Articles	Latin America: Rocky Economic Road Ahead	1	25X1
			25X1
	With most of the major Latin American economies straining to meet large debt servicing burdens, we foresee another year of economic stagnation. Moribund economic conditions already are creating tougher political and popular opposition to financial policies and reforms envisioned in the Baker Plan.		25X1
	Haiti: Leftist Activity Growing	7	25X1
			25X1
	President Namphy's policy of allowing freedom of action for all political groups has led to an upsurge in leftist activity. The Communist Party and other leftist groups are		25X1
	trying to undermine the government by inciting unrest.		25X1
	Cuban and Soviet Party Congresses: Spring Thaw, Followed by Clouds	11	25X1
			25X1
	Soviet-Cuban ties have entered a warming trend highlighted by recent party congresses in Moscow and Havana. Cuba's economic policies now parallel Soviet emphasis on reform and more efficient management, but this compatibility is not matched by equally congruent foreign policy priorities		25X1
	Uruguay: Prospects for the Broad Front	15	25X1
			25X1
	The leftist Broad Front coalition has grown into Uruguay's third major political force and hopes to challenge the country's traditional two-party system. It, however, must first deal with internal frictions.		25X1

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<b>Paraguay: Bleak Economic Prospects</b>	[redacted]	19	25X1
[redacted]			25X1

The economy is undergoing severe strain from drought, low prices for commodity exports, and an overvalued exchange rate. President Stroessner's inadequate response to the bleak outlook is contributing to increased capital flight, narcotics trafficking, and political discontent. [redacted]

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**Briefs**

[redacted]			25X1
Cuba: Punishing the Wayward Elite	[redacted]	25	25X1
Paraguay: Increased Opposition Activity	[redacted]	26	25X1
Bermuda: Pressing for Tax Concessions	[redacted]	27	25X1

*Articles have been coordinated as appropriate with other offices within CIA. Comments and queries regarding this publication may be directed to the Chief, Production Staff, Office of African and Latin American Analysis, [redacted]*

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## Latin America Review

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### Articles

## Latin America: Rocky Economic Road Ahead

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Economic performance in the major Latin American economies was disappointing in 1985. Growth was lackluster, inflation remained high, and living standards stayed depressed. With most economies straining to meet large debt servicing burdens, we foresee another year of economic stagnation. We are already seeing signs that moribund economic conditions are creating tougher political and popular opposition to financial policies and reforms envisioned in the Baker Plan. Thus, most Latin American countries will continue to press Washington for political solutions to the debt problem and bargain with creditors for easier repayment terms to foster stronger growth.

### A Disappointing Performance

According to preliminary data, Latin American economies grew 3.4 percent in 1985, equaling the 1984 pace. Only Brazil—which accounts for one-third of the region's output—enjoyed strong economic growth, expanding at 8.3 percent.

In the other key debtor nations, economic performance oscillated in a narrow range:

- Argentine GDP fell 3 percent as the government imposed austerity measures to break hyperinflation.
- In Venezuela, delays in implementing public-spending programs and stagnant private investment—exacerbated by sagging oil revenues—kept growth depressed in 1985 for the seventh consecutive year.
- Mexican efforts to reflate the economy before the 1985 state elections, however, helped the economy grow by 2.7 percent and joblessness to post a slight decline.

**Table 1** *Percent*  
**Latin America: GDP Growth**

	1982	1983	1984	1985	1986 <sup>a</sup>
Latin America	-1.5	-3.1	3.4	3.4	0.3
Latin America, excluding Brazil	-2.7	-3.0	2.8	0.9	-1.5
Argentina	-6.3	3.0	2.0	-3.0	NEGL
Bolivia	-6.6	-8.6	-3.7	-2.5	NEGL
Brazil	0.9	-3.2	4.5	8.3	3.5
Chile	-13.1	-0.5	6.2	2.4	2.2
Colombia	1.0	1.2	3.6	2.0	2.0
Ecuador	1.1	-1.6	4.6	3.2	-4.0
Mexico	NEGL	-5.2	3.7	2.7	-3.5
Peru	-0.2	-12.0	4.4	1.5	1.5
Uruguay	-9.4	-5.0	-1.8	NEGL	1.5
Venezuela	0.7	-5.6	-1.1	NEGL	-2.0

<sup>a</sup> Projected.

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Inflation generally remained high judged by Latin American historical standards, thereby compressing purchasing power. Although Argentina and Bolivia adopted programs to halt hyperinflation—which peaked at about 1,000 percent and 23,500 percent, respectively—December 1985 data showed Argentine inflation running at 46 percent and Bolivian price increases at a still dangerous 540-percent annual rate. Official statistics indicate Brazil experienced its third

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9 May 1986

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***Danger of a Debt Crisis***

*[redacted] Mexico is fast approaching its position of August 1982, when it was unable to meet its debt obligations. On that occasion, quick action by Mexican finance officials, the US Government, and commercial creditors averted a major crisis. [redacted]*

*We see substantial differences in the current situation and believe greatly increased incentives exist for Mexico and other major debtors to take radical action to reduce debt service payments. Although debt policies are driven by each country's balance-of-payments position and relations with creditors, the same deflationary pressures that plague Mexico also affect other Latin debtors. The increasing political nature of the debt problem makes negotiations between debtors and commercial creditors more difficult than in the past. This time, both sides are not as likely to push for agreement because they believe that Washington once more will come to the rescue. [redacted]*

*Although the financial crisis is concentrated in Mexico, it could engulf the region. We are particularly concerned about the consequences if Mexico's financial predicament again causes creditors to "cut and run" by reducing trade credits, withdrawing interbank deposits, and suspending disbursement of medium-term credits to the region's other debtors. In that event, the resulting cash-flow problems almost certainly would play into the hands of populists throughout Latin America who believe that the current debt strategy condemns their countries to stagnation. A stronger voice for nationalist forces in the region not only would result in financial setbacks for US banks but also would damage other US economic interests and lower the probability of attaining US political objectives. [redacted]*

*year of price increases in the 200-percent range and Peruvian President Garcia's stimulative economic policies pushed inflation toward 200 percent a year. Tighter fiscal policies lowered inflation to less than 10 percent in Venezuela, the only major country in the region with single-digit price increases. [redacted]*

Taken together, Latin American living standards remained depressed. Government statistics indicate that per capita income throughout the region was still below the peaks recorded in the late 1970s. Persistent high inflation caused real wages to fall in 1985 in every major country except Brazil, where they rose 12 percent. Real wages plunged 20.5 percent in Peru and 9.9 percent in Argentina last year—the most severe declines—and 8.0 percent in Mexico. Moreover, stagnant economic growth resulted in rising unemployment in several Latin American countries. In Argentina, urban unemployment rose 2 percentage points to 6.6 percent, while Colombian urban joblessness averaged 14.2 percent, up from 13.5 percent in 1984. [redacted]

***An Early Look Ahead***

On the basis of projections from various econometric forecasting services, we believe most of the economies will face another year of lackluster performance. Although some will benefit from the oil price drop—notably Brazil and Chile—and all will receive a boost from the pickup in OECD growth and lower interest rates, the continuation of economic adjustment programs will hold recovery in check. For example, we believe President Sarney's recently imposed anti-inflation program and the effects of the drought will more than halve the Brazilian GDP growth rate, while the drop in oil prices will require new retrenchment in Mexico, Venezuela, and Ecuador. Argentina and Bolivia are holding to tough anti-inflation programs, and fiscal and economic adjustments policies needed to make significant progress against inflation are being pursued in Chile, Colombia, and Uruguay. [redacted]

Debt servicing requirements and the persistent problem of capital flight will also limit the region's growth potential. Capital will continue to flow out of Latin America in 1986, albeit at a slower pace than last year. According to United Nations data, net flows of profits, interest, and principal totaling \$30.4 billion left the region in 1985, up 18 percent from 1984, as commercial lenders became more cautious about new financing. Moreover, net interest payments as a share of exports of goods and services increased for most

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**Table 2**  
**Latin America: Consumer Price Inflation**

*Percent, December over December*

	1981	1982	1983	1984	1985
Latin America	57.6	84.8	131.1	184.9	316.3
Latin America, excluding Bolivia	58.2	81.3	127.8	151.7	145.1
Argentina	131.2	208.7	433.7	688.0	385.4
Bolivia	25.2	296.5	328.5	2,177.2	8,170.5
Brazil	91.2	97.9	179.2	203.3	248.5
Chile	9.5	20.7	23.6	23.0	26.4
Colombia	27.5	24.1	16.5	18.3	23.5
Ecuador	17.9	24.3	52.5	25.1	24.4
Mexico	28.7	98.8	80.8	59.2	63.7
Peru	72.7	72.9	125.1	111.5	158.3
Uruguay	29.4	20.5	51.5	66.1	83.0
Venezuela	10.8	7.9	7.0	13.7	9.1

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Latin American countries, compressing import capacity and spurring calls for new approaches to the debt problem. Although the recent decline in interest rates should reduce debt service by \$11 billion, according to the London-based American Express Bank, the interest burden will remain high.

As the terms of trade for Latin American debtors drift lower in the wake of world disinflation, we foresee little prospect for export windfalls that will boost economic recovery. Only coffee prices are likely to rise strongly this year. Official trade statistics indicate Latin American economies continue to rely heavily on commodity exports, which are unlikely to rise significantly in price in 1986, according to most economists. Although only 45 percent of Brazilian exports are primary products, two-thirds of Chilean and Colombian foreign sales consist of commodities. Primary products account for 80 percent of Argentine and Mexican exports; and in Peru and Venezuela, they amount to more than 90 percent of shipments.

Political events and trends in individual countries also have the potential to threaten economic prospects by undermining investor confidence and disrupting plans. In Chile, especially, several years of sustained terrorist activities and the specter of a Philippine-like upheaval may dampen investment and slow growth. Politically motivated shifts in economic policies such as those in Mexico and Peru have also heightened perceptions of risk and will continue to discourage investment and promote capital flight. Even transitory events such as the insurgent attacks on the Palace of Justice in Colombia and the recent mutiny of General Vargas in Ecuador serve to lessen investor confidence and distract the affected governments from their economic priorities.

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#### **The Fallout**

Governments throughout Latin America almost certainly will remain under popular pressure this year to back away from austerity, which officials and

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**Table 3** *Percent*  
**Latin America: Interest Payments as**  
**Share of Exports of Goods and Services**

	1981	1982	1983	1984	1985
Latin America	27.6	40.5	35.9	35.7	36.0
Argentina	35.5	53.6	58.4	58.7	54.5
Bolivia	32.1	43.5	44.4	63.1	60.0
Brazil	40.4	57.1	42.4	38.0	40.5
Chile	38.8	49.5	39.4	50.0	46.5
Colombia	21.8	25.8	26.5	23.6	23.0
Ecuador	24.3	30.1	27.4	27.8	24.5
Mexico	29.0	46.0	39.3	40.2	37.0
Peru	24.1	25.1	29.8	34.0	34.5
Uruguay	12.9	22.4	24.8	33.8	35.5
Venezuela	12.7	21.0	21.6	17.5	22.5

**Table 4**  
**Latin America: Terms of Trade**  
**(Index: 1980 = 100)**

	1981	1982	1983	1984	1985
Latin America	92.4	84.2	82.7	86.1	83.6
Argentina	103.8	87.6	85.0	93.9	83.0
Bolivia	93.5	93.3	99.5	99.3	96.7
Brazil	84.1	80.5	82.0	88.9	85.5
Chile	80.8	72.8	76.7	71.7	68.9
Colombia	81.0	87.5	89.6	92.8	91.5
Ecuador	90.0	83.2	77.6	76.1	73.8
Mexico	99.7	84.1	81.0	80.4	78.2
Peru	80.7	71.7	70.6	71.6	69.3
Uruguay	88.4	88.3	89.1	92.7	87.3
Venezuela	98.3	97.4	94.3	100.5	98.0

public figures increasingly equate with servicing foreign loans. Earlier this year, Fidel Velazquez, head of the powerful Mexican Confederation of Workers, asserted that present debt arrangements impose an unbearable burden that "cannot last forever," an indication of the growing political debate within Mexico over suspending payments on the debt. Moreover, Argentine unions successfully staged a one-day general strike in January to protest high debt payments, and the Peronist opposition to President Alfonsin is endorsing more confrontational policies on the debt. In a January interview on Brazilian television, Finance Minister Funaro mused about the willingness of the region's leaders to pay foreign banks while per capita incomes decline, inadequate social security systems fall apart, and the economic infrastructure crumbles. [ ]

The upper and middle classes will also probably pressure their governments to avoid the political risks in undertaking structural economic reforms to satisfy creditor demands. According to USIA-sponsored opinion polls made in November 1985, a majority of the urban public in Brazil, Colombia, and Venezuela prefer centralized control of the economy by the

government (which was equated with democracy). Mexicans split evenly between strong government control and US-style economic policies. [ ]

Despite growing internal opposition to continuing debt service, few Latin American governments are likely to advocate radical collective or unilateral moves to ease the debt burden. Neither Castro's call for a debt moratorium nor Peruvian President Garcia's plan to limit debt service to 10 percent of export earnings has attracted support to date, and both would risk further isolation by continuing to push their schemes. Statements by leftwing opposition groups throughout the region favoring the repudiation of at least part of the debt have garnered virtually no popular support and have been opposed by every government in the region. [ ]

Throughout the remainder of 1986, however, individual governments are likely to use growing domestic support for tougher stances on debt to try to extract concessions from creditors. We believe that the Latin debtors that face new financial negotiations

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this year will also continue to look to Washington for political solutions to their debt problems. As a result, we believe Latin American governments—individually and under the aegis of the Cartagena Group—will press for implementation of the Baker Plan and lower interest rates and interest rate spreads, as they did at the Cartagena Group meeting in February.

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**Haiti: Leftist Activity**  
**Growing** [redacted]

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President Namphy's policy of allowing freedom of action for all political groups has led to an upsurge in leftist activity. In addition to overt political organizing, the Unified Party of Haitian Communists (PUCH) and other leftist groups are working clandestinely to undermine Namphy's government by inciting unrest [redacted]. These groups are not working together, however, and thus far show little capability for coordinated action. The ruling council feels compelled to let these organizations operate openly because of a desire to avoid losing domestic and international support. Although the government has made some effort to monitor leftist subversion, it has little intelligence capability. Nevertheless, the ruling council hopes eventually to undercut the effectiveness of radical groups by exposing agitator activity.

[redacted]

**Communist Activities**

The PUCH is emerging as one of the more active leftist groups in Haiti. [redacted]

[redacted] the party had approximately 300 members in Haiti and abroad. [redacted]

[redacted] many exiled Communists either have returned to Haiti or plan to soon. The Communists may be gaining support in the south, where the party appears to have a structure in place, [redacted]

[redacted] The Haitian Communists were not noted in the past for developing coherent plans of action, but they now appear to have a two-track strategy of subversion aimed at keeping the government weak and defensive, and political activity designed to forge alliances with non-Communist elements. [redacted]

[redacted]

[redacted] the Communists were partly responsible for the disturbances that took place in Port-au-Prince on 24 March. On that date, antimilitary demonstrators brought the capital to a halt for four hours with roadblocks, burning tires, and

scattered violence. We have no evidence, however, of Communist involvement in the agitation that provoked the police overreaction resulting in eight deaths in the capital on 26 April. Nevertheless, Haitian officials reportedly are worried that the Communists might be able to mount continuous destabilizing antigovernment demonstrations, possibly by paying agitators to cause disturbances. [redacted]

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**Secret****Other Leftist Players**

Several radical groups are acting independently of the PUCH to incite popular unrest and establish power bases of their own. Most are led by returned leftist exiles. [redacted]

[redacted] far-right members of Haiti's wealthy elite are paying leftist elements to create disturbances aimed at destabilizing the Namphy government. The Embassy says Namphy and other senior Haitian officials believe the right is attempting to use leftists to frustrate moves toward democracy:

- Ruling council member Regala told US officials he has evidence that members of the Miami-based Hector Riobe Brigade were responsible for inciting the crowd during a large demonstration at Fort Demanche in Port-au-Prince on 26 April. Regala says he believes the brigade members received money from an unknown source to provoke the incident.

[redacted]

- [redacted] members of the National Democratic and Progressive Party of Haiti are returning from exile to engage in open political activity. Last year the US Embassy described this group as the most radical of Haiti's many exile organizations. Far left socialist in ideology, some of its members reportedly received paramilitary training in Libya. The group, headed by Lionel Laine before he was killed in a gun battle with police in Port-au-Prince last October, plans to appeal to the lower classes by advocating a redistribution of land and wealth, [redacted]

[redacted]

[redacted]

Local leftist leaders also have emerged since Duvalier's ouster in February. Their popularity results from personal charisma rather than support for their ideology:

- Lucien Pardot, a teacher from Gonaives, is emerging as one of the most active and influential leftists in Haiti, [redacted]. Pardot reportedly has wide-ranging contacts and influence over individuals in the Catholic Church, youth groups, and labor unions. [redacted] Pardot is a Marxist who accepts the principles and aims of the PUCH, but does not belong to the party because of personal animosity toward Communist leader Rene Theodore. Pardot reportedly is organizing seminars on workers' rights in Port-au-Prince as a means of disseminating leftist views.

- [redacted] several leaders of the Gonaives-based vigilante group Dechoukage are leftist in orientation. Since February, Dechoukage members have hunted down and executed former militiamen and others associated with the Duvalier regime. [redacted]

Because returned exiles lead many of the leftist groups, they may be as unable or unwilling to coordinate their actions in Haiti as they were when they were abroad. Haitian groups of all political hues tend to be built around a leader, and personal rivalries may be keeping leftist parties from collaborating with each other. There probably is also some tension between local and returned exile leftists, as in the case of Pardot and Theodore. Some local leftists may believe that they played an important role in the popular movement that ousted Duvalier, and view the returnees as interlopers who were safely in exile during the period of unrest beginning last November.

[redacted]

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**Government Response**

The ruling council hopes to monitor subversive groups and expose violent leftist tactics to public scrutiny, but is severely limited by lack of resources. In the absence of a domestic intelligence service, the government decided in March to use a 36-man squad of undercover police to track PUCH activities, [redacted]

[redacted]. This unit is ill-prepared for intelligence work; during the Duvalier years its main function reportedly was to monitor tourist movements in Port-au-Prince [redacted]

[redacted] that plans for the new service are still at an early stage of development. [redacted]

President Namphy personally made an effort to sensitize Haitians to the dangers posed by subversives in the wake of the 26 April incident. Namphy appeared on television the following day expressing sympathy for the victims and condemning the agitators who were clearly seen in filmed news reports to have provoked the disturbance. Namphy appears to have been at least partly successful in conveying the idea that agitators are manipulating Haitians to act against their own interests. [redacted]

**Outlook**

Namphy appears prepared to continue allowing leftists to operate openly in order to avoid appearing repressive. [redacted]

[redacted] the ruling council has decided to allow complete freedom of action for all political groups and unrestricted right of return for all exiles. The council reportedly hoped this would serve as a sign of progress and reconciliation. Although the ruling council reportedly is uneasy with open Communist and leftist organizing and the return of many radical exiles, we have no evidence it plans to alter its policies. [redacted]

For the near term, the left in general views the present weak transitional government as providing an opportunity to propagate their views openly and build

their organizations without harassment. We believe leftists will lack the capability to make a bid for power any time soon because of their weaknesses and shortcomings. The Communists in particular still are largely bereft of capable and imaginative leaders and organizers. Should the Namphy government collapse and a political vacuum ensue, however, the prospects for the left could brighten considerably. Although individuals rather than groups historically have wielded more influence in Haitian politics, we believe the Communists and other leftists will garner some support by appealing to popular expectations of a better life and exploiting frustration with slow economic progress. In addition, the novelty of free political activity will probably attract new members to the leftist parties. [redacted]

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**Cuban and Soviet Party  
Congresses: Spring Thaw,  
Followed by Clouds**

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Party congresses earlier this year in Havana and Moscow have underscored a warming trend in Soviet-Cuban ties following the earlier chilled relations during much of 1984-85. The high points in the congresses were the presence in Havana of the number-two man in the Politburo, Yegor Ligachev, who praised Cuba and said it could depend on Soviet friendship, and President Castro in Moscow, who lauded Soviet-Cuban ties in more slavish tones than he had used at the last CPSU Congress in 1981.

Soviets responded positively by sending Politburo member Mikhail Solomentsev to Cuba in May 1985 for ceremonies commemorating the 25th anniversary of the renewal of diplomatic relations between Cuba and the USSR. When Soviet Foreign Minister Shevardnadze stopped over in Cuba in October, he conveyed Gorbachev's "warm wishes."

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For some two years prior to the Havana and Moscow party congresses, Cuban-Soviet relations were strained by frictions over economic relations and foreign policy. Soviet economic aid had leveled off, ending a more open-ended arrangement dating back to the early 1960s. Moscow's oil flow dropped, in part because of declining oil production in the USSR. Kremlin technicians in Cuba were complaining bitterly about Havana's lack of economic efficiency, especially in sugar production, and Havana's nagging inability to meet sugar export promises to the Council for Mutual Economic Assistance (CEMA).

In foreign policy, Moscow and Havana have been at odds over Soviet insistence on East-West priorities and Cuba's Third World preferences. The Soviets glossed over Maurice Bishop's death in October 1983 in Grenada, where they supported his main rival in contrast to Cuban support of Bishop. In Nicaragua during 1984-85, the Soviets tended to keep a low profile in the context of East-West gamesmanship, while the Cubans were more hawkish in their verbal support and physical presence. Moscow has been playing down North-South issues, stressing the limits to Soviet aid and the need for Third World self-reliance. Cuba has been proclaiming the importance of the debt issue and the need for Latin American countries to repudiate their debts to Western creditors. Still, Cuba in other respects has stayed in tune with Moscow by:

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Soviet leaders, however, were disenchanted with Cuba's persistent food rationing, which gave socialism a black eye. Gorbachev's drive for economic reform magnified Moscow's ire over Cuba's poor economic management and flawed sugar industry. Castro, under Soviet economic pressure, was responding with his own program to meet export promises to CEMA and improve Havana's record in economic efficiency—largely by limiting imports and increasing overall austerity.

- Strengthening diplomatic ties to the new democracies in South America.
- Advocating a negotiated settlement of Nicaragua's Central American problems, while still supporting Sandinista consolidation.
- Working closely with the Soviets in Angola and Ethiopia.

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Cuba's recent accommodation to Soviet economic pressure had begun to produce a thaw in relations with Moscow before the Havana Congress in February. While Castro's refusal to attend the funeral of Konstantin Chernenko in March 1985 and meet with Gorbachev accentuated Castro's displeasure with the state of relations, his moves toward economic reforms signaled sensitivity to Soviet pressure. The

**The Party Congresses Compatible  
Economic Strategies**

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Like Gorbachev's report to the 27th CPSU Congress and in those of the Soviet republic party congresses, Castro devoted much of his long speech to the Havana Congress to criticizing economic shortcomings and calling for reform. He criticized Cuba's social services, industrial stagnation, central planning

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9 May 1986

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failures, agricultural inefficiency, bloated government bureaucracy, and poor tourist system. Like the Soviets, Castro spoke of future increased reliance on market mechanisms, improved quality of output, and worker incentives to stimulate production. He stressed the need to meet Cuba's export commitments to CEMA, adopt new technologies, improve management, and continue austerity—all music to Soviet ears. [ ]

Castro's assault on Cuba's economic system has been accompanied by personnel changes in the state ministries and—as announced at the Third Party Congress—in the Central Committee and Politburo of the party. Following Moscow's lead, Castro has replaced older, less efficient managers—many of whom date back to Cuba's revolutionary days and are devoted followers of the *lider maximo*—with younger and better trained technicians who may provide the kick needed in the economy. New full members in the Politburo, for example, include Vilma Espin Guillois, Raul Castro's wife and the first woman named to this level. Castro, unsurprisingly, remains the party's First Secretary, and his brother, Raul, Second Secretary. [ ]

By calling for accelerated economic development and reforms in the Cuban economy, Castro earned Soviet praise and set the scene for repairing strained relations. *Pravda* gave unusual prominence to Castro's main report in Havana, suggesting special efforts to signal fraternal warmth. Ligachev's speech to the Havana Congress praised Cuba for its alleged international prestige, its social accomplishments on behalf of the Cuban people, and its example in defending socialism against aggression. Ligachev noted that the Soviet Union has fulfilled and will fulfill undeviatingly its commitments to Cuba. In words that must have warmed Castro's heart, Ligachev said that Cuba can rely on the Soviet Union. [ ]

Castro's speech to the Soviet Party Congress in late February underlined the warming trend. Adopting more slavish praise than he used in 1981, Castro cited Moscow's "colossal political, economic, social, and scientific successes" and the "immense glory" of its defense efforts. Castro in 1981 described Leonid

Brezhnev's speech as "calm and firm;" he termed Gorbachev's main report as "brilliant and valiant." Cuban media attention to the Soviet Party Congress was enormous. The party daily *Granma* devoted an entire front page to large excerpts from Castro's address and included a box the width of the page: "We place our trust in the great fatherland of Lenin, in the Soviet people, in its glorious party, in its leadership, in you, comrade Gorbachev, in your ideas, in your dynamic style, in your tireless struggle for peace, Leninist principles, and communism. We trust you, and we support you." [ ]

Compared to Castro's speech to the 26th Party Congress, his 1986 version reflects Cuba's growing preoccupation with economic issues. Castro argued that only economic development can remove the contradictions between capitalism and socialism, and he called more directly for Soviet economic assistance to the Third World. Behind this focus on Third World economic development—a struggle Castro described as "no less stimulating" than that of avoiding nuclear war—lies unrelenting Soviet pressures: leveled off economic aid, declining petroleum supplies, and criticism for Cuban economic inefficiency. These pressures—not likely to disappear in coming months—help account for what Western diplomatic observers describe as the "toadying" tone of Castro's remarks in Moscow. [ ]

#### Out of Tune on Foreign Policy

Castro's alignment with Gorbachev's economic approach is not replicated in foreign policy. Moscow remains keyed to an East-West focus essentially at odds with Cuba's North-South agenda. Signs of this running disagreement appeared at both congresses. Cuba's party leadership adopted a hastily crafted resolution approving—and explaining—Castro's remarks on foreign policy during his main report to the Cuban congress. The resolution—not previously distributed to the delegations and read by Vice President Carlos Rafael Rodriguez rather than by Castro—is more explicit in its support for detente than Castro's own report. While we do not know precisely why the party leadership determined to issue

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this resolution—a practice not followed in the Second Party Congress—it appears that the Soviet delegation was not entirely delighted over Castro's:

- Faint praise of detente and glossing over Soviet-US strategic issues, like space-based defensive systems.
- Concentration on Latin America more than on recent Soviet efforts at arms control.
- More hawkish views on confrontation with the United States, rather than emphasizing the need for all socialists to struggle for peace. [ ]

The new foreign policy resolution rectified these differences by emphasizing the importance of East-West strategic issues, peaceful coexistence, dialogue and constructive negotiations, general and complete disarmament, and unity in opposing the US policy of confrontation. [ ]

But the matter did not end here, because Castro once again underscored his foreign policy differences with the Soviets in the final two sessions of Havana's Congress. Speaking without notes, tired, and highly emotional, Castro espoused his more hawkish views on confrontation with the United States, calling capitalist society a "world of vampires that lived on the blood of other people and its own sons." Again demonstrating his skepticism about Soviet-US detente, Castro said if the United States increased aid to the "Somozistas" (Contras) in Nicaragua, Cuba would do "everything possible" to step up aid to the Sandinistas. As for Angola, Castro castigated mounting US support for UNITA, pointing out that Cuba is prepared to back the Popular Movement for the Liberation of Angola for "10 years, 20 years, 30 years, if necessary." Nicaragua's Ortega immediately reported these glad tidings back in Managua. The Soviet media did not. When asked to approve Castro's assistance to Nicaragua and Angola by a show of hands, the congress delegates did so. But no text of this oral resolution has appeared subsequently. [ ]

Persistent differences between Moscow's East-West priorities and Castro's Third World focus carried over to the 27th Soviet Congress. Where Gorbachev's main address virtually ignored the Third World—focusing instead on Soviet-US arms control issues—Castro centered his remarks on the Third World. To the possible discomfort of his Soviet colleagues, he

explicitly asserted that the nations of the Third World "expect and are certain they will receive maximum solidarity from the socialist community in their struggle for just economic gains." [ ]

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Havana's focus on Third World economic issues probably reflects Castro's growing uneasiness over Moscow's long-term economic commitments to Cuba. It also suggests a disagreement with Moscow over the relevance of the US-Soviet dialogue in light of the threat to Cuba posed by the United States. [ ]

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Castro probably is concerned that Gorbachev's lack of discussion of familiar topics like the Middle East and Central America portends a downgrading of revolutionary objectives in the Third World in the context of new domestic economic and East-West priorities. Castro attempted to use the 27th Congress to remind his Soviet patrons of Cuba's credentials as a Third World leader and thereby gain leverage to ensure Moscow's economic and military commitments to Havana. [ ]

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#### Prospects

In view of the Soviet and Cuban interests served by their close ties, the relationship almost certainly will remain intact during the next five years. Still, it will not be friction free, and the key questions are how serious will be the strains developing during this period and under what conditions are they likely to sharpen? In bilateral economic relations, pressures are mounting on Cuba's middle-age revolution:

- Current sugar production is likely to be just short of disastrous, given the combination of drought and damage wrought by Hurricane Kate last autumn.
- The drop in sugar production means Havana again will be unable to meet its commitments to supply the USSR and other CEMA members.
- Cuba's economic performance still is not improving at a time when Gorbachev is emphasizing economic efficiency.
- This year's hard currency earnings from sale of excess sugar on the open market—originally aimed at US \$230 million—could be nearly wiped out by the need to supply CEMA.

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- Without hard currency from sugar sales, Cuba will have to borrow more from Western creditors in order to import needed Western technology and consumer goods.

The slide in international oil prices reduces Cuba's hard currency even more, because Havana has been selling unused Soviet oil on the open market. The result is that Cuba's hard currency earnings from oil sales, which bring in nearly half of its hard currency revenues, will be greatly reduced. Pressures to borrow from the West will grow, probably increasing Cuba's outstanding debt of \$3.2 billion with Western creditors.

In foreign policy, current differences in world view and foreign policy priorities could be aggravated if:

- Soviet-US arms control moves ahead while Cuba perceives Moscow backing away from its internationalist duties—as implied by 27th Congress speeches of Angola's dos Santos and Ethiopia's Mengistu.
- Cuba's more hawkish views on support for revolutionary regimes and movements, especially in Central America, lead Havana toward policies too far out front for Soviet comfort.
- Castro perceives that Moscow may sacrifice its interests on the doorstep of East-West issues.

Indicators of these potential sources of friction include:

- Soviet-US agreement on a date for the second summit meeting; and inclusion of regional issues discussion at that time.
- Increased Cuban personnel sent to Nicaragua and Angola as a response to heightened US support of the Contras and UNITA; widening evidence of direct Cuban involvement in fighting side-by-side with the Sandinistas.
- Sharpening complaints from Angola, Ethiopia, and Nicaragua over the level of Soviet economic support.

Nevertheless, it is premature to predict sharp stresses in the Soviet-Cuban relationship. Soviet economic and military aid to Angola, Ethiopia, and Nicaragua indicate that Gorbachev—thus far—is not shying away from key foreign commitments. Current relations between Moscow and Havana exude warmth—signaling that both leaderships are eager to demonstrate the value they place in each other's contributions. Perhaps in response to Castro's public concern with the level of Soviet economic aid, Moscow and Havana followed the 27th Party Congress with the announcement of new Soviet development aid to Cuba over the next five years amounting to a 50-percent increase over the previous five years. Development aid accounts for about 10 percent of total Soviet aid to Cuba.

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## Uruguay: Prospects for the Broad Front

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The leftist Broad Front (FAU) coalition has grown into Uruguay's third major political force and hopes to challenge the country's traditional two-party system. The Front, however, must first deal with internal frictions that could hamper the coalition's ability to present itself as a viable alternative by the 1989 election. Nevertheless, we believe that under the leadership of former Gen. Liber Seregni the Front will continue to expand its popular support and will maintain considerable influence in Congress and within the labor movement.

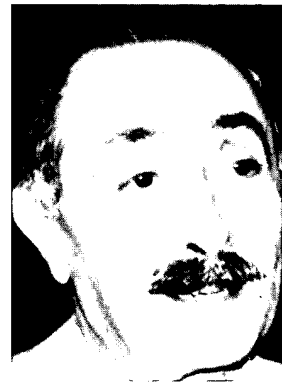
### Background

In the early 1970s, a group of leftist political parties and factions formed a coalition to challenge the traditionally centrist Blanco and Colorado Parties. The coalition, known as the Broad Front, captured 18 percent of the national vote and almost won the mayoralty of Montevideo in the 1971 election. The military took control of the government in 1973, banning all political parties and arresting the Broad Front's leader, retired Gen. Liber Seregni. The Front remained inactive until Seregni's release from prison in March 1984. Seregni then quickly reestablished the coalition and became involved with the Colorado Party in negotiating with the armed forces to return Uruguay to democracy, signing an accord that established conditions for a smooth transition to civilian rule.

Despite a decade of political inactivity, the FAU improved its standing in the 1984 election. Although the military proscribed the charismatic Seregni from running for president, the Front won 20 percent of the congressional vote—not far from the second-place Blanco Party's 33-percent tally—and, according to press reports, was supported by over two-fifths of first-time voters.

### Coalition Members

The Broad Front consists of a variety of parties, including Christian Democrats, Socialists, Communists, and independent leftists. Although the



**Liber Seregni**  
*Leader of  
the Broad Front*

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*Moderating force within the leftist Broad Front coalition . . . polls show him to be one of the most popular political figures in the country . . . retired general officer, known as the people's general . . . has eyes on 1989 presidential election, according to US diplomats . . . longtime friend of President Sanguinetti . . . former assistant military attache to the United States . . . resigned from the military in 1969 to protest government crackdown on subversives . . . imprisoned in early 1970s for protesting military takeover . . . reinstated as general by Sanguinetti in 1985 to the displeasure of the military, who consider him a leftist traitor . . . 70 years old and in good health.*

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Front's components differ widely in ideology, they all fall to the left of the Blanco and Colorado Parties.

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The biggest and most moderate faction in the FAU is the Movement for the Government of the People (known as List 99), headed by Senator Hugo Batalla. List 99 split off from the Colorado Party and,

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9 May 1986

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**Uruguay: Strength of  
Broad Front Members <sup>a</sup>**

Faction	FAU Vote (percent)		Number of Plenum Seats
	1971 Election	1984 Election	
Advanced Democracy (including Communist Party)	33	28	18
Christian Democrats	20	10	6
Independent Democratic Left	23	6	15
List 99	10	39	6
Socialists	12	15	6
Independents	2	2	6

<sup>a</sup> Statistics vary slightly, depending on the source, because of the complexity of the Uruguayan voting system.

according to the US Embassy, lacks both the well-defined ideology and disciplined internal structure of most FAU parties. Nevertheless, it is becoming increasingly influential: Batalla, for example, represented the FAU in the negotiations with President Sanguinetti and the Blancos that recently produced the "National Accord"—a three-year plan to reactivate Uruguay's economy.

The Communist Party also plays a leading role in FAU activities. According to US Embassy reporting, the Moscow-line party is the best organized and disciplined of FAU parties. its membership has increased threefold since Sanguinetti legalized the party in March 1985, and that much of this growth stems from an infusion of younger, more militant members. The Communists—long a dominant force in organized labor—have played a significant role in labor demonstrations and strikes that have plagued Uruguay over the past year.

The Broad Front's most radical faction is the Independent Democratic Left, a loose confederation of far-left splinter groups. Although relatively small and divided, it has carved itself a niche on the

Uruguayan political scene and is jockeying with the Communists for influence in the labor sector. The Independent Democratic Left has led the Broad Front's attacks on US policy in Central America and on Sanguinetti's moderate economic program.

The remnants of the Tupamaro guerrilla movement are interested in joining the Front. Tupamaro leader Raul Sendic claims to support democracy and asserts that his group has repudiated violence. His efforts to join the Front have been hampered, however, by the Christian Democrats, who fear open association with the Tupamaros would hurt the Broad Front's public image.

**Divisions Within the Front**

FAU leader Liber Seregni plays a decisive role in the Front, imparting a measure of unity to what, in our view, might otherwise be a completely unwieldy coalition. The former general has largely divorced himself from internal factionalism and, according to the US Embassy, considers himself independent of the FAU's component groups, and thus able to focus on the Front's common goals. His leadership skills and political savvy have won him popular support from all FAU factions, according to the Embassy.

The press reports that one of Seregni's goals is to reorganize the Front's decisionmaking structure. The coalition's far-left groups have more votes in the Front's governing board, or plenum, even though the FAU's moderate forces have been more successful electorally.<sup>1</sup> For example, List 99 won 40 percent of the FAU vote in 1984, but only has six of the 57 votes in the plenum, while the Independent Democratic Left—which captured only 6 percent of the coalition's votes in the last elections—has 15 plenum seats. The leftist factions oppose reform and fear they will lose influence to moderate sectors during the Front's coming national conference.

<sup>1</sup> This anomaly exists because seats on the governing board are apportioned according to each faction's showing in the 1971—as opposed to the 1984—election, in which the far-leftist elements within the Front generally outpolled the more moderate sectors.

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Control over Uruguay's labor confederation is also a source of acrimony within the Front. The Communists have dominated labor in the past, but recently have lost some support to the Independent Democratic Left. [ ]

[ ] last year the Communists adopted a more militant stance, dividing both the FAU and the labor movement. Moreover, various FAU factions walked out of the labor congress last November when the Communists tried to monopolize the meeting. Seregni has called for a new labor congress later this year to preserve labor unity. [ ]

#### **The Front and Sanguinetti's Government**

The FAU's internal differences are reflected in the coalition's dual approach to the government. Sectors such as List 99 are trying to portray the Front as a viable, responsible party that will mount a serious challenge to the Colorados in the 1989 election, while ultraleftists in the FAU are more concerned with undermining the Sanguinetti government and thwarting his moderate policies in areas such as human rights and foreign debt. [ ]

**Human Rights.** We believe the Supreme Court will decide sometime over the next six months to give the military courts jurisdiction over possible trials of officers for human rights violations. Sanguinetti would strongly support such a move because it would calm military fears of Argentine-style trials. The FAU, however, is demanding civilian prosecution of officers accused of abuses during military rule. The Front will probably continue to push for trials whatever the Supreme Court's decision, thereby aggravating the armed forces and obstructing the administration's efforts to close the book on the human rights question. [ ]

**Economic Policies.** The Front, according to the Embassy, seeks economic revitalization through increases in purchasing power and real income, versus Sanguinetti's push for increased export markets. The Front also proposes increased state planning, the nationalization of banks and key industries, and price controls. The more leftist factions support Fidel Castro's call for nonpayment of the foreign debt. [ ]

[ ] the Communists—worried that their rhetoric is becoming

counterproductive—may shift their focus from the foreign debt to internal economic policy issues. [ ]

**The National Accord.** In April the FAU joined the Colorados and Blancos in signing a vague national agreement to support democracy and revitalize Uruguay's economy. Nevertheless, according to Embassy reporting, the FAU has reservations on crucial economic sections of the accord—the proposal for a balanced budget, for example. The FAU submitted its own more leftist proposals for social and economic reforms and criticized certain aspects of the agreement. In our judgment, the FAU signed the accord primarily to avoid congressional isolation and to not appear obstructionist in light of Sanguinetti's efforts for national cooperation and unity. We believe that the Front has not altered its basic economic perspective and that it will not give carte blanche to Sanguinetti's initiatives. [ ]

#### **Outlook**

We believe the Broad Front will be too consumed by internal problems over the next year to challenge the Sanguinetti government. Seregni will probably expend his energies on reorganizing the FAU plenum and keeping the peace between factions in the coalition. FAU longer term prospects, in our view, are clouded by the two-party tradition that is so ingrained in Uruguay's political culture. Moreover, the traditional parties have some attractive prospects for the 1989 presidential election, including Blanco leader Wilson Ferreira and Colorado Vice President Enrique Tarigo. [ ]

The FAU, in our view, will probably maintain its current role as Uruguay's third-largest political force. The Front could expand its popular support if the electorate—spurred, for example, by the failure of Sanguinetti's economic reform program—were to shift away from the Colorado Party. We believe, however, that the prime beneficiary of any serious misstep by Sanguinetti would be the Blanco Party, which has successfully articulated political opposition to the dominant Colorados over the past half century. [ ]

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There is an outside chance , however, that the Blancos may not be able to play this traditional role if the Colorados fall on hard times. Party leader Wilson Ferreira [redacted]

[redacted] could die before 1989, leaving the Blanco Party without a unifying leader or a charismatic presidential candidate. Under these circumstances, Seregni—especially if he consolidates the coalition and maintains his considerable personal popularity—might become a serious contender for the presidency and the Front could substantially improve its representation in Congress. [redacted]

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## Paraguay: Bleak Economic Prospects

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Paraguay's economy is undergoing severe strain from drought, low prices for commodity exports, and an overvalued exchange rate. We expect the economy to contract by up to 8 percent this year, with agricultural production plummeting by almost 20 percent. Declining exports and investments will increase the current account deficit and probably force Asuncion to draw down its nearly depleted foreign reserves and accumulate more debt payment arrearages. President Stroessner's inadequate response to the bleak economic outlook is contributing to increased capital flight, narcotics trafficking, and political discontent. Most critically, trade partners and foreign banks are cutting credit lines and withholding loan disbursements, leaving Paraguay with an unmanageable foreign payments situation.

### Financial Difficulties

Paraguay is one of two South American countries that have not rescheduled their foreign debt, but we judge that Paraguay's day of reckoning is fast approaching. Asuncion has financed its \$361 million current account deficit by drawing down its international reserves and by accumulating an estimated \$250 million in commercial payment arrears on its \$1.8 billion debt. According to the US Embassy, foreign banks are growing increasingly impatient over Asuncion's continued foot-dragging and are loath to syndicate new credits. The Embassy estimates that Paraguay will need to devote 70 percent of its foreign exchange earnings this year to meet its projected \$248 million interest bill.

Paraguay is also facing a severe capital flight problem. The Central Bank's net foreign reserves fell by 16 percent to \$400 million between September 1984 and December 1985. The Embassy predicts that reserves may fall below \$300 million this year. Central Bank President Acosta told the Embassy in late December that under current policies the foreign exchange reserves would be totally depleted by the end of 1986.

### Paraguay's Hydroelectric Projects

Since 1973 Paraguay has been developing its main physical resource—hydroelectric power—under bilateral treaties with Brazil and Argentina. The projects, which we view as important to the long-term development of Paraguay's economy, will eventually make the country one of the world's major energy exporters. Over the past four years, however, net inflows of foreign exchange from hydroelectric-related activity have declined steadily from their peak of \$449 million—13 percent of GDP—in 1981 to about \$68 million—barely 2 percent of GDP—in 1985. Asuncion's Central Bank forecasts that the earnings of Paraguayan workers on hydroelectric projects will generate only \$100-150 million this year.

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It is becoming increasingly clear, in our view, that the payoff from Paraguay's hydroelectric push will not come until the 1990s, when the dams will be at full generating capacity. The largest and most advanced project—the Paraguayan-Brazilian Itaipu dam—generated considerable income for Asuncion during the construction stage. However, as the building phase of Itaipu nears completion, investment has centered on capital-intensive tasks—such as the installation of electricity-generating equipment—that have not required extensive use of Paraguayan labor, thereby cutting the country's earnings. Moreover, the dam's huge generating capacity is underutilized: only three of the 18 turbines are functional, and low demand and inadequate transmission lines for electricity have brought lower-than-projected sales revenues. Construction delays have also bedeviled the second-largest dam—the Yacyreta project financed by Argentina—because Asuncion's maintenance of an overvalued guarani has forced Buenos Aires to pay wages three times higher than the Paraguayan salary for comparable work.

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ALA LAR 86-011  
9 May 1986

**Secret****Paraguay: Current Account Trends, 1982-86***Million US \$*  
(except where noted)

	1982	1983	1984	1985 <sup>a</sup>	1986 <sup>b</sup>
Current account balance	-444	-409	-336	-361	-334
Trade balance	-272	-220	-209	-379	-100
Exports	564	490	530	310	250
Imports	-836	-710	-739	-689	350
Net services	-189	-195	-137	-168	-150
Net inflows related to binational corporations	321	294	172	68	100
Debt service ratio ( <i>percent</i> )	20	28	26	57	70
External debt (disbursed medium and long term)	1,204	1,469	1,654	1,700	1,800

<sup>a</sup> Estimated.<sup>b</sup> Projected.**Shriving Economy**

The drought affecting South America's southern regions is having a disastrous impact on the agriculturally based economy and is lowering living standards for the majority of the population. We believe that cotton and soybean exports—which accounted for more than 80 percent of Paraguay's \$310 million export revenues in 1985—may not reach \$200 million this year. Crops primarily produced for domestic consumption are also suffering. For example, corn production this season may plummet by more than 40 percent; it has tripled in price since December and feed shortages could also drive down pork and broiler production. Asuncion has recently responded to the situation by placing price controls on several staples, but we believe these will only aggravate shortages in urban areas and increase black-market activity.

The agricultural decreases will impact heavily on the rest of the economy. We estimate that industrial activity may decline 7 percent this year, because it is agrobusiness oriented and dependent on the farming sector for raw materials. Shortages are already acute in fuel alcohol, for example. Construction will almost certainly contract this year and commercial activity may decline by 10 percent because farmers—who

make up 44 percent of Paraguay's work force—will have lower disposable incomes. Employment and real wages in all sectors are likely to drop.

Finally, the bleak economic performance expected will reduce the government's revenues and fuel inflation. The 1986 budget—which provided for a small surplus—was prepared before the full impact of the drought was apparent. We believe that the fall in tax receipts will push the budget into the red and that the Central Bank will cover the shortfall by printing money, thereby accelerating the rate of inflation and further weakening the guarani.

**Asuncion's Economic Mismanagement**

Paraguay maintains a complicated, inefficient exchange rate system that penalizes exports, subsidizes government debt service payments, and encourages corruption. Since February 1985 the system has consisted of four basic rates ranging from 160 guaranis per US dollar for public-sector capital and external debt service payments to the free market rate of 850 guaranis per US dollar for most imports.

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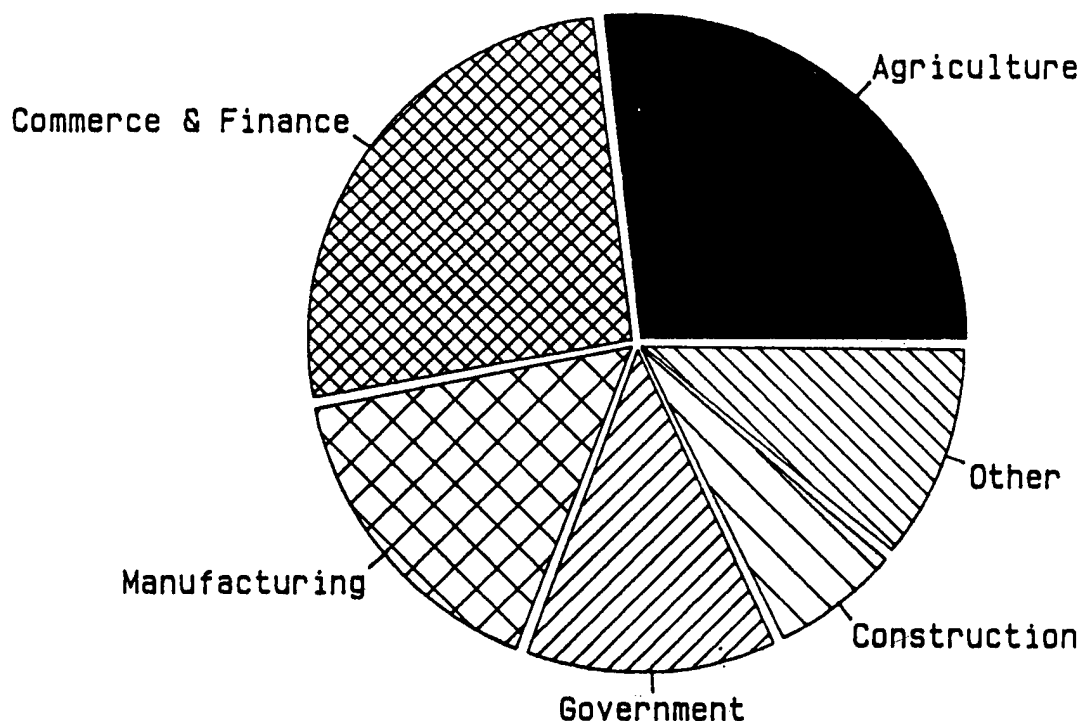
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## PARAGUAY: REAL GDP BY SECTOR-1985\*



\*estimated

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Multilateral financial institutions are showing heightened concern over the gap between the official and parallel exchange rates. The World Bank recommended that Asuncion make major changes in its interest rate policy, abolish multiple exchange rates, and peg the guarani at 400 to the dollar. Since mid-1985 the Bank has effectively cut off loans to Paraguay because Asuncion insists on underfinancing IBRD projects by applying the official exchange rate. In August, the IMF—concerned that Paraguay's deteriorating payments posture would soon force a rescheduling of its foreign debt—proposed a thorough adjustment of the national economy, including a

tighter monetary policy, a revised income tax system, and, most importantly, a devaluation of the guarani. Asuncion opted instead only to form a commission to study the Fund's recommendations.

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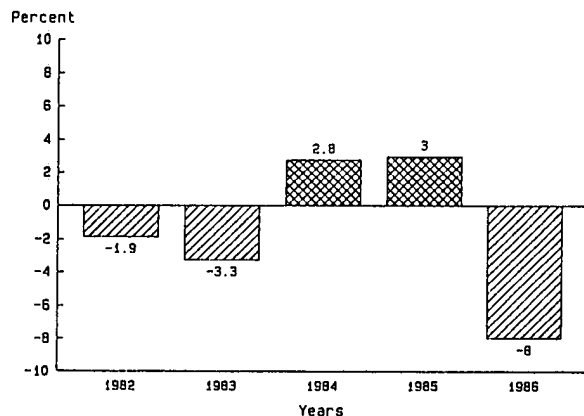
Neighboring countries also have been pressing Stroessner to devalue. According to Embassy reporting, Argentina and Brazil—Paraguay's major trade partners and financiers of hydroelectric projects along Paraguay's borders—are unhappy with the unprofitable exchange rate for payments on these

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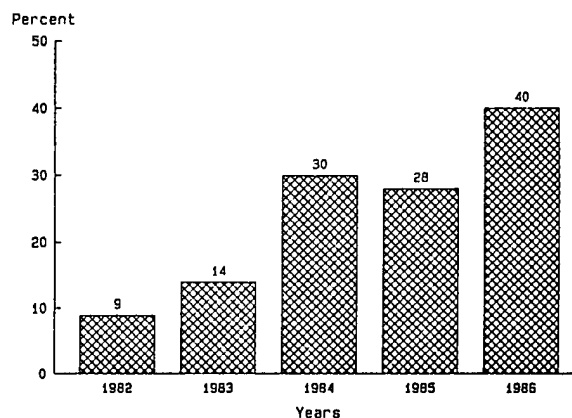
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## PARAGUAY: SELECTED FINANCIAL AND ECONOMIC INDICATORS, 1982-1986

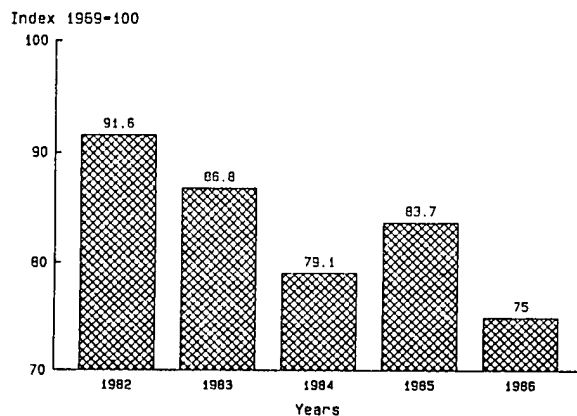
Real GDP Growth



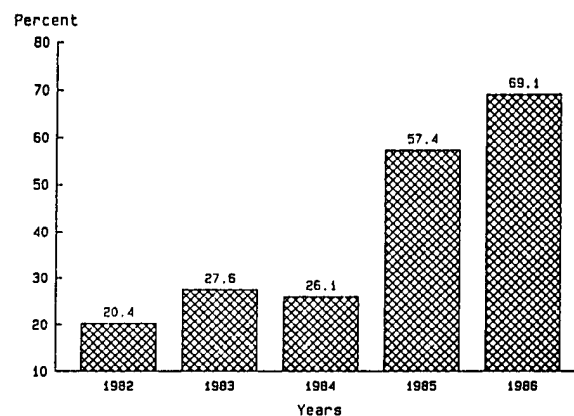
Consumer Price Growth



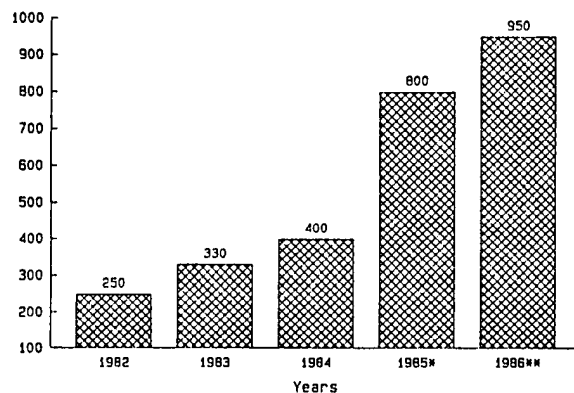
Real Wages



Registered External Debt Service Ratio\*

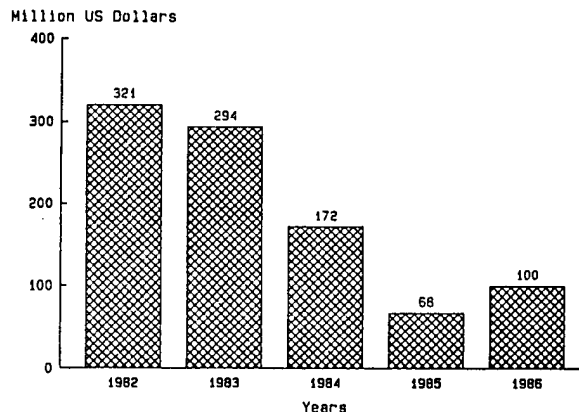


\*As a percent of registered merchandise exports plus foreign exchange earnings from hydroelectric projects

Average Exchange Rates:  
Public Sector Debt and Free Market.

\*estimated  
\*\*projected

Hydro Earnings



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projects. Unless Paraguay reduces the value of the guarani, we expect further delays in dam construction and substantial revenue losses for both Argentina and Paraguay. In addition, press reports indicate angry creditors have embargoed Paraguayan ships in three countries and Tokyo has cut financing for the airport at Ciudad Presidente Stroessner. [REDACTED]

Most recently Paraguay's normally reticent business community has spoken out. In February, the Federation for Production, Industry, and Commerce—the umbrella organization for business associations—called for an economic reactivation program. The Federation specifically proposed a free market exchange rate to stimulate legal trade, reduce incentives for corruption, and attract foreign investment. The Paraguayan business sector has usually been hesitant to criticize the Stroessner regime for fear of jeopardizing profitable dealings with the government. Business leaders, however, apparently now feel that monetary, fiscal, and credit policies are so inappropriate that they must make their views heard before the economy slides into a deep recession. [REDACTED]

President Stroessner has rejected all proposals for economic reform. Stroessner's grasp of economics, in our view, has never matched his political savvy; his refusal to devalue appears to be based partially on his reported belief that political stability is directly related to the stability of the currency. According to the Embassy, the President fears a devaluation might unleash a spiral of inflation, leading to more devaluations, severe economic difficulties, and political discontent. Stroessner also recognizes that a devaluation would raise the cost of servicing the foreign debt. Rather than increase taxes to boost revenues, he prefers to keep the exchange rate low and tax exports. [REDACTED]

While many high-level Paraguayan officials seem to recognize the net costs of the overvalued guarani, none have managed to get Stroessner's ear. He flatly rejected a recommendation by Central Bank President Acosta to devalue in order to slow the drain on Asuncion's foreign exchange reserves. According to the Embassy, Stroessner pays more attention to a group of economically unsophisticated sycophants. [REDACTED]

A final factor reinforcing the current exchange rate policy is the corruption that permeates the government. According to the Embassy, informed businessmen believe that government officials personally profit from the guarani's artificially low rate. For example, the press exposed a scandal at the Central Bank last year in which officials created dummy corporations that purchased dollars at the official 160 guarani rate and then resold them at the black-market rate of 800 guaranis per dollar. The Embassy estimates that such schemes may have cost the Bank about \$100 million over the past five years.

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[REDACTED]

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[REDACTED]

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#### **The Impact of an Overvalued Currency**

Failure to adjust the exchange rate is undermining domestic confidence in the guarani, spurring large dollar withdrawals from banks, and increasing capital flight. This skittishness was dramatically demonstrated in July, when, according to the Embassy, rumors that the government might nationalize dollar deposits precipitated a \$50 million run on the banks. [REDACTED]

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[REDACTED]

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[REDACTED] We believe capital flight will accelerate as long as the exchange rate remains unchanged, putting pressure on Asuncion's already depleted foreign reserves. [REDACTED]

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The current value of the guarani also is reducing Asuncion's exports, discouraging foreign investment, and making it more difficult for Paraguay to manage its foreign debt payments. The overvalued currency will further depress declining revenues for cotton and soybeans. Without an exchange rate adjustment, we expect that both export value and the trade surplus will continue to shrink, aggravating the existing problems of arrearages in debt servicing. [REDACTED]

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The overvalued exchange rate is also encouraging smuggling and narcotics trafficking. The Embassy reports that such illicit activities may involve as much as 15 percent of the work force and some of the country's most powerful political and military officials. They generate roughly one and one-half times the revenues of registered foreign trade and account for about a third of the country's real GDP, according to press reports. Smuggling and drug trafficking, according to the Embassy, buttress Stroessner's political stand in the short run by enriching powerful elites who might challenge a more intrusive administration. In the long run, however, we believe that the proliferation of such practices corrodes the government's legal and moral authority and virtually destroys its ability to direct or regulate any significant aspects of the national economy. [ ]

Festering economic problems are also increasing political discontent and uncertainty—already on the rise because of 75-year-old Stroessner's failure to lay the groundwork for an orderly succession. [ ]

[ ] elements within the Colorado Party, the military, and the business sector are concerned and divided by the corruption and economic mismanagement of the Stroessner regime. The President, however, remains fully in command and has responded to demonstrations and protests with sharp limits on civil rights. We believe that he will step up the use of such repressive measures, thereby courting more frequent confrontations with Washington over human rights violations in the coming months. [ ]

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#### **Outlook and Implications for the United States**

We believe Asuncion will be hard pressed to tackle current economic problems without undertaking major monetary adjustments, preferably as part of a wider economic stabilization program. We doubt, however, that Stroessner will bend to pressure for devaluation over the next few months. Under these circumstances, we expect that the payments position will become so untenable that Paraguay may be forced to abandon its current policy mix by early next year and seek debt rescheduling with foreign banks in the context of an IMF-supported stabilization program. [ ]

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Unless Stroessner changes his course, we believe the recession and export disincentives will increase contraband activity and enlarge the underground economy. The major impact on US interests will be rising narcotics trafficking, which is also promoted by official corruption and an ineffective drug enforcement apparatus. Paraguay is already a major transit site for Bolivian cocaine destined for Europe and the United States, and is also a significant marijuana grower. The persistence of current economic and political conditions, in our view, will increase the country's role as a trafficking nation and may spur the emergence of significant cocaine cultivation and processing on Paraguayan soil. [ ]

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**Secret****Latin America  
Briefs**

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**Cuba****Punishing the Wayward Elite** 

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The assignment of Antonio Perez Herrero to Ethiopia as ambassador, in our opinion, is one more example of Havana's tendency to punish officials for incompetence, misbehavior, or other failings by dispatching them to unattractive posts abroad. Perez Herrero, who recently presented his credentials in Addis Ababa, was stripped of his seats in the party's Politburo and Secretariat at a special plenum of the Central Committee in January 1985 because of his "deficiencies and repeated mistakes." His downfall apparently stemmed from unacceptable personal behavior, shortcomings in his performance as the party's Secretary for Ideology, and his uncompromising hard line in foreign policy

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**Secret***ALA LAR 86-011  
9 May 1986*

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[ ] Because his bureaucratic comeuppance is public knowledge, there is a risk that some observers will view his assignment as a sign that Havana has put relations with Ethiopia on the back burner. [ ]

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Ethiopia apparently also served as a purgatory for Perez Herrero's immediate predecessor, Ambassador Francisco Cabrera, who was in charge of Cuba's Air Force when its MIGs, in an embarrassing and costly overreaction, sank a Bahamian gunboat in May 1980. Cabrera at the time was a vice minister of the armed forces with the rank of Division General and presumably had to shoulder the blame for the incident. It probably was also the deciding factor in causing him to lose his seat in the Central Committee during the party congress earlier this year. [ ]

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Perez Herrero's performance in Addis Ababa so far suggests his chances for readmission to the Politburo and Secretariat are dim. He has made a poor first impression on his Spanish-speaking colleagues in the diplomatic community, according to the US Embassy, and has not visited them on normal protocol calls or shown any genuine interest in Ethiopian-Cuban relations. The Venezuelan Charge, who has been in Addis Ababa more than four years, describes Perez Herrero as the weakest of the three Cuban ambassadors who have served in Addis Ababa during that period. [ ]

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**Paraguay****Increased Opposition Activity** [ ]

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The National Accord—a coalition of fragmented opposition parties—has become increasingly vocal against President Stroessner's regime in the past few weeks. The Authentic Radical Liberal Party has been the most active party, sponsoring a number of rallies and demonstrations calling for a national dialogue aimed at moving Paraguay toward democracy. The government has reacted with growing forcefulness to restrain protestors. During a rally on 13 April, police wielding clubs injured 30 participants and detained 13 party members, according to US Embassy reporting. Later in the month police used tear gas to break up a large student demonstration in downtown Asuncion. The press reports the Authentic Radical Liberals are planning another rally in Asuncion later this month. [ ]

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Paraguayans are openly challenging the President's authoritarian rule for the first time since he took power in 1954. We expect further unrest as uncertainty and criticism intensify regarding the succession question—Stroessner's term ends in 1988—and the worsening economy. As opposition grows, we believe Stroessner will clamp down even harder against the opposition, increasing the likelihood of serious violence and human rights abuses. [ ]

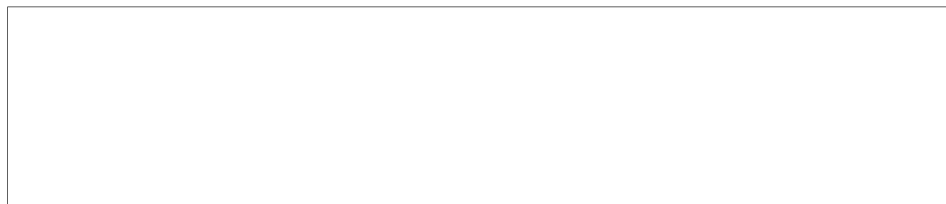
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Meanwhile, a leader of the ruling Colorado Party has told US officials of discontent in the Paraguayan military below the senior ranks. He believes that Paraguay is facing a leadership crisis and that change without violence is unlikely.

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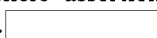
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**Bermuda****Pressing for Tax Concessions**


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The recent push for independence from Britain and threats to charge rent for US military installations largely reflect Premier Swan's growing frustration with stalled negotiations for a new bilateral tax treaty with the United States. Swan wants a treaty that would eliminate US federal excise tax on insurance premiums paid to companies based in Bermuda, similar to the US-Barbados accord in effect since February. At the same time, Swan is pressing for US tax deductions for American businesses that hold conventions in Bermuda, a concession enjoyed by several other countries, including Jamaica. According to US officials in Bermuda, one large insurance firm will leave next month, and several others are seriously considering relocating to Barbados, a move that would put the country's second-largest industry at risk. Hotel industry officials claim to be losing millions of dollars in convention bookings because of the convention tax deduction exclusion for Bermuda. Generally weak earnings from tourism—a sector that supplies some 30 percent of GDP—lend support to hoteliers' assertions, and political pressures are increasing on Swan to find a solution. 

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In a meeting last February with members of his United Bermuda Party caucus, Swan explicitly announced that he intends to press for independence—necessary before base rents could be charged—if tax relief efforts fail. He probably would drop his independence move for now if both his government and the United States could reach agreement on the final draft of the tax treaty, according to US officials in Bermuda. Swan probably has ambitions to be the first leader of an independent Bermuda, but he failed to get the support of his party's caucus for the proposed independence referendum because key members reportedly are concerned about the economic costs of independence. 

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Despite the caution in the ruling party, proindependence sentiment is strong in the colony. Members of the opposition parties are likely to support independence, according to reporting from the US Consulate. As a result, the issue is likely to resurface and could pass, particularly if lackluster economic performance continues. Proponents of independence would work to persuade others that the financial benefits—particularly US base rents—would outweigh additional costs, including establishment of a foreign service and possible declines in US tourist spending. 

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